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LDC Debt: Current and Emerging Issues

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An Intelligence Assessment

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**LDC Debt: Current and
Emerging Issues**

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Key Judgments

*Information available
as of 15 November 1988
was used in this report.*

The LDC debt situation remains precarious, especially for the debtors, despite a range of actions taken since 1982 that have reduced the risk of a major debt-related disruption to the international financial system. These actions have insulated the creditors to some degree, but the LDCs continue to suffer from low economic growth and net outflows of needed capital, while creditor banks remain reluctant to commit new funds, and reschedulings continue to be frequent.

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Given this situation, we believe the international financial community will face several debt-related issues over the next year:

- LDC requests for new money and reschedulings will be the most immediate issue. Several key debtors—including Argentina, Venezuela, the Philippines, and Colombia—are seeking new money or rescheduling packages from commercial bank creditors. Mexico will also be asking for more favorable terms on its previously rescheduled debt as well as new money. These negotiations will probably be prolonged and contentious, especially in Argentina's case. Creditor banks as well as governments will probably resist granting large new loans and instead will explore additional new debt relief mechanisms.
- On the political front, recent and forthcoming elections in Latin American countries could result in new leaderships that will adopt more confrontational policies toward creditors. Newly elected leaders in Mexico City and Quito already are leaning toward more hardline positions with their creditors. Even in countries where elections are not scheduled, domestic dissatisfaction with continued economic hardship could stiffen debtor unwillingness to continue to abide by the current debt strategy.

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Debt relief—in the form of new financing at concessional rates or outright debt reduction—is probably the most important debt-related issue facing the international financial community. While the LDCs have been pushing for a reduction in their debt burden for some time, creditors—both official and private, particularly in Europe and Japan—are becoming more receptive to the notion of debt relief. Such moves abroad are almost certain to increase pressure on Washington and major US banks to soften their resistance to these proposals. Commercial bank views on debt relief, however, already are diverging given the banks' differences in exposure and business strategies.

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Managing the LDC debt problem could be complicated by emerging views of the role of multilateral financial institutions—principally the IMF and World Bank—as well as by challenges to US influence on the debt management strategy. For the multilaterals, the primary issue is how these institutions will be funded and how their responsibilities will be divided. We expect the IMF to follow the recent World Bank capital increase with its own proposal next spring, while major Western governments choose sides in backing one of the two institutions for the lead management role in the debt crisis. In addition, we expect Japan, and perhaps other Western creditor governments, to seek a larger role in directing LDC debt policy.

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The tensions associated with the LDC debt problem will continue well into the 1990s, in our view. Longer term economic developments, such as an expected slowdown in world trade growth, probably will not improve and could worsen the LDCs' financial position. Moreover, creditors will remain reluctant to provide new money if the LDCs fail to implement needed economic reforms. Although the odds are small, debtor countries could decide to take collective action on the debt problem if their domestic economic situations deteriorate further.

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